Southeast Volusia Hospital District Board of Commissioners

and

Bert Fish Medical Center Board of Directors

Joint Meeting June 11, 2013

Meeting Agenda

1. **Health Care Futures Background**
2. **Role of Health Care Futures**
3. **Transaction Overview**
4. **Summary of Key points**
5. **Conclusions**

1. Health Care Futures Background

- Health Care Futures (HCF) is a strategy consulting firm of 20 professionals with locations in Chicago and Minneapolis. HCF was founded in 1996 and focuses on assisting health care executives and board members reach their organizations' financial and strategic goals. Our historical client base includes integrated delivery systems, academic medical centers, single- and multi-specialty physician group practices, managed care and contracting organizations. HCF has established one of the largest dedicated health care strategy practices in the industry by providing exceptional service, innovative solutions, and demonstrated results for our clients.

- Edward McGrath is a partner and founding principal of HCF. Prior to HCF, Edward served as a partner for KPMG in their Health Care consulting practice. During nearly 30 years as a healthcare consultant, Edward has completed analyses for more than 40 hospital transactions.

2. Role of Health Care Futures

HCF was engaged to review the Proposals and determine which of the offers presented by HMA and Halifax appeared to be more financially advantageous for BFMC and SEVHD.

- **Timing.** HCF was engaged in late May of 2013 for completion by early June 2013.
- **Data Limitations.** Due to the limited time to complete analyses, HCF relied on the data received from BFMC for completeness and accuracy. Additionally, HCF had access to the original Proposals, and, as we understand, the majority of the follow up responses from both parties. It should be noted that HCF did not meet or speak with any representatives of either Halifax or HMA. HCF relied on BFMC and SEVHD September 30th 2012 Audited Financial Statements for other analyses.

2. Role of Health Care Futures (Continued)

- **Other factors.** Equally important and in some cases more important, the following factors were not considered in the HCF analyses.
  - Cultural fit.
  - Ease of transition.
  - Form of structure.
  - Governance and role of remaining organizations such as SEVHD.
  - Mission.
  - Strategic alignment.
  - Sunshine Law.
  - Quality of care provided.
  - Historical relationships.
  - Medical Staff relationships/comfort with new “Parent”.

3. Transaction Overview: Halifax

- **Structure.** Halifax will become the Sole Corporate Member of BFMC.
- **Upfront cash.** The Halifax Proposal includes no upfront cash commitment, but Halifax will assume all liabilities.
- **Liabilities assumed by Halifax.**
  - **Capital lease.** Halifax stated in their Proposal that they will guarantee payments to SEVHD.
  - **Working capital loan.** Halifax states they will pay off the working capital loan from BFMC to SEVHD over 4 years.
  - **Defined benefit pension plan liability.** The Halifax Proposal states that it will assume this liability and any difference at time of closing.
  - **Unknown liabilities.** Halifax states in their Proposal that they will assume unknown liabilities that surface in the due diligence process.
- **Assets retained by SEVHD.** Under the Halifax proposal, all BFMC assets other than land will be transferred to Halifax as the sole corporate member of BFMC.
- **Capital commitment by Halifax.**
  - Years 1-5: Committed to invest $35.0M
  - Years 6-10: Anticipated but not committed capital expenditures of $30.0M
  - Clearly there will need to be investments by Halifax after the first five years, but the Halifax proposal did not make a commitment. However, as noted capital will need to be invested at a minimum to approximate prior years depreciation level of approximately $3.5M.

3. Transaction Overview: Halifax (Continued)

- **Ad Valorem tax revenue.** Assumptions relative to SEVHD funding of bad debt and charity care through the Ad Valorem taxes – the Halifax Proposal indicated some level of these taxes are assumed to continue for the entire lease period.
- **EBITDA sharing opportunity.** In the event BFMC produces a EBITDA margin greater than 12.0 percent or $10.0M (greater of the two), 50 percent of this excess will be distributed to SEVHD to reduce Tax Revenues for uncompensated care services.
  - The average EBITDA margin for A- rated hospitals per Standard and Poor's approximated 10.2 percent in 2011.
  - BFMC's EBITDA margin in FY2012 approximated 6.4 percent.
- **Other structural options.** Halifax has indicated it would be open to an upfront payment for BFMC assets, but no further financial terms were provided in the Proposal or in written responses. Thus the HCF financial review is based on the option presented with financial terms.

Note: BFMC calculated EBITDA margin for FY2012 excluded the one-time nonoperating revenues from the legal settlement.

3. Transaction Overview: Health Management Associates (HMA) – Option 1 - HMA Lease

- **Structure.** HMA will acquire the use of the operations, property, plant, and equipment through a long-term lease with SEVHD.
- **Upfront cash.** The HMA Proposal states $50.0M in cash and approximately $3.0M cash for supplies and prepaid expenses will be paid by HMA at closing. However HMA will not assume any liabilities and SEVHD will be responsible for all known and unknown liabilities of BFMC.
- **Liabilities assumed.** Under the HMA proposal, all liabilities will be retained by the SEVHD and will need to be paid out from the cash received at closing.
- **Assets retained by SEVHD.**
  - Current assets
  - Investments
- **Capital commitment by HMA.**
  - Years 1-5: Committed to invest $15.0M
  - Years 6-10: Committed to invest $25.0M

3. Transaction Overview: Health Management Associates (HMA) – Option 1 - HMA Lease (Continued)

- **Ad Valorem tax revenue.** Assumptions relative to SEVHD funding of charity care and bad debt through the Ad Valorem taxes – the HMA Proposal indicates these taxes would equal the maximum funding contribution for the first seven years and then the HMA proposal indicates it would plan to eliminate Ad Valorem tax revenue after that point.
  - In the Proposal and in the written responses reviewed by HCF this is not stated as a commitment but rather it is anticipated. However, we understand that HMA has made a verbal commitment relative to elimination of tax support in no more than seven years.

3. Transaction Overview: Health Management Associates (HMA) – Option 2 - HMA and SEVHD Joint Venture

- **Structure.** HMA and SEVHD would jointly own a new LLC that would be the operator of BFMC. HMA has indicated it would be open to various ownership percentages up to 49 percent ownership for SEVHD. The suggestion from HMA of 80 percent HMA ownership and 20 percent SEVHD ownership of the LLC is assumed for this analysis.
  - **Sunshine Law.** HMA has indicated the number of Board Members named by SEVHD will need to be below that required for BFMC to not operate under the Sunshine Law.
  - **Risk/Reward.** This structure brings additional risk to, and potential benefit for, SEVHD. However as a minority owner it will have minimal decision making authority.
- **Upfront cash.** The upfront cash from HMA would be adjusted for the amount of ownership in the LLC by HMA. (80 percent)
- **Other Financial components.** No changes from Option 1 in the assumptions relative to liabilities assumed, assets retained or the capital commitment by HMA.
- **Ad Valorem tax revenue.** No changes from Option 1 to the Ad Valorem tax revenue assumed.

3. Transaction Overview: Bert Fish Medical Center (BFMC) – Historical Balance Sheet

		Audit Report FY2012 ($'s in 000s)
Assets		
Current assets:		
Cash and investments	$	4,405
Accounts receivable, net		6,067
Prepaid expenses and supplies		3,013
Total current assets		**13,485**
Assets limited to use		20,192
Capital assets, net		27,665
Pension asset		2,043
Interest in other assets at the Foundation		163
Other assets		234
Total assets	**$**	**63,782**
Liabilities		
Current liabilities:		
Current portion of long-term debt	$	2,039
Accounts payable and accrued expenses		9,314
Total current liabilities		**11,353**
Long-term debt, less current portion		12,546
Working capital obligation		6,175
Self-insurance liabilities		441
Interest rate swap		229
Total liabilities		**30,744**
Fund balance		33,038
Total liabilities and fund balance	**$**	**63,782**

Notes:

Includes working capital loan (does not eliminate) given Halifax commitment to repay this loan to the District.

Includes $163k in investment in Foundation. This is eliminated in the audited financial statements. However, for purposes of this analysis it was assumed the Foundation was no longer a component of BFMC.

3. Transaction Overview: Bert Fish Medical Center (BFMC) – Historical Income Statement

		Audit Report FY2012 ($'s in 000s)
Operating revenues:		
Net patient service revenues	$	67,707
Other operating revenues		415
Total operating revenues		**68,122**
Operating expenses:		
Salaries and wages		38,192
Supplies		16,225
Purchased services		10,611
Professional services		3,550
Other supplies and purchased services		9,167
Depreciation and amortization		3,488
Interest expense		307
Total operating expenses		**81,540**
Operating income (loss)	**$**	**(13,418)**
Non-operating revenues:		
District funding		14,432
Other (1)		450
Total non-operating income		14,882
Excess of revenues over expenses	**$**	**1,464**

(1) Excludes Legal settlement, net

4. Summary of Key Points: Financial comparison of Halifax and HMA proposals

Based on Audit report FY2012 ending September 30th (In millions)

	Halifax	HMA *(4)*	HMA Joint Venture
Upfront cash:			
Upfront payment for lease	$ -	$ 50.0	$ 40.0
Payment for supplies and prepaid expenses *(1)*	-	3.0	2.4
Total upfront cash	**$ -**	**$ 53.0**	**$ 42.4**
Net working capital retained	4.1	-	-
Cash retained	20.2	-	-
Capital assets	27.7	27.7	27.7
Assumed liabilities:			
Capital leases	$ 14.5	$ -	$ -
Working capital loan	6.2	-	-
Self-insurance liability & other LT liabilities	0.4	-	-
Interest rate swap	0.2	-	-
Sub-total	**21.3**	**-**	**-**
Unknown liabilities *(2)*	TBD	-	-
Unfunded pension liability *(3)*	11.2	-	-
Total liabilities	**$ 32.5**	**$ -**	**$ -**
Subtotal before Capital commitment	**$ (19.5)**	**$ 25.3**	**$ 14.7**
Capital commitment (present valued to 2013) (5)	29.4	28.3	28.3
Anticipated Capital (present valued to 2013) (5)	19.0	-	-
Subtotal after Capital commitment and anticipated Capital	28.9	53.6	43.0
JV cash flow (present valued to 2013)	-	-	7.0
Net impact of balance sheet retained by SEVHD	-	(10.5)	(10.5)
Net proceeds including anticipated Capital	28.9	43.1	39.5
Net proceeds including only committed Capital	**$ 9.9**	**$ 43.1**	**$ 39.5**

(1) Amount subject to due diligence.
(2) Medicare, Medicaid and other liabilities identified between Letter of Intent and closing date.
(3) Halifax has identified it may adjust this number in due diligence.
(4) Plus retention by the district of assets and liabilities (see attached retained balance sheet)
(5) Present value of Capital investments back to 2013 at a 6.0 percent discount rate.

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4. Summary of Key Points: Retained Balance Sheet per HMA proposals – Balance Sheet without Capital Assets

Based on Audit report FY2012 ending September 30th (In millions)

	FYE September 30th		
Assumed assets:	**Audit**	**HCF Adjusted**	
Current assets:			
Cash	$ 4.4	$ 4.5	
Accounts receivables	6.1	5.2	**(1)**
Supplies	-	-	
Current assets sub-total	**10.5**	**9.7**	
Cash and investments	20.2	20.2	
Other assets	0.4	0.4	
Other assets sub-total	**20.6**	**20.6**	
Total assets	**$ 31.1**	**$ 30.3**	
Assumed liabilities:			
Current liabilities:			
Current portion of capital lease	$ 2.0	$ 2.0	
Accounts payable and accrued expenses	8.3	8.3	
Current liabilities sub-total	**10.3**	**10.3**	
Capital leases	12.5	12.5	
Working capital loan	6.2	6.2	
Self-insurance liability	0.4	0.4	
Interest rate swap	0.2	0.2	
Other liabilities sub-total	**19.3**	**19.3**	
Total liabilities sub-total	**29.6**	**29.6**	
Unfunded pension liability	**9.3**	**11.2**	**(2)**
Fund balance/ net cash retained	(7.8)	(10.5)	
Total liabilities & fund balance	**$ 31.1**	**$ 30.3**	

(1) HCF adjusted assumes a 15 percent reduction to AR for cost of collection and AR not collectible. Due to time and access HCF did not review AR aging and therefore the assumption is based on HCF experience.

(2) HCF assumed actual pension liability to be 20 percent higher than that identfied in the footnotes and the 2012 Audited Financials for BFMC

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3. Transaction Overview: HMA Joint Venture Pro Forma and present value of future cash flows.

Projections provided by HMA to SEVHD

BFMC - Joint Venture HMA(80)/SEVHD(20)
Dollars in 000s

	Year 1	Year 2	Year 3	Year 4	Year 5	Years 6 - 25	Total
EBITDA	$ 6,586	$ 8,872	$ 11,280	$ 12,867	$ 14,522		
Less:							
Capital expenditures	3,000	3,000	3,000	3,000	3,000		
Total cash flow available for distribution	**753**	**2,939**	**5,246**	**6,733**	**8,288**		
SEVHD Cash flow	**151**	**588**	**1,049**	**1,347**	**1,658**		
Present value of cash flows	**$ 131**	**$ 445**	**$ 690**	**$ 770**	**$ 824**	**$ 4,133**	**$ 6,993**

Notes: HCF did not audit or review HMA's calculation for Total Cash Flow available for Distribution. It is unclear how HMA calculated the difference between cash flow available for distribution and EBITDA.

4. Summary of Key Points: Present value of future Capital investment

– For purpose of these analyses HCF assumed a constant per year investment based on the identified committed and/or anticipated capital investment by each Party.

Committed

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	10 Year Total
					Committed Capital Spend						
Halifax	$ 7.0	$ 7.0	$ 7.0	$ 7.0	$ 7.0	$ -	$ -	$ -	$ -	$ -	**$ 35.0**
HMA	$ 3.0	$ 3.0	$ 3.0	$ 3.0	$ 3.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0	**$ 40.0**
					Present Value of Future Capital Spend						
Halifax	$6.6	$6.2	$5.9	$5.5	$5.2	$0.0	$0.0	$0.0	$0.0	$0.0	**$ 29.4**
HMA	$2.8	$2.7	$2.5	$2.4	$2.2	$3.5	$3.3	$3.1	$3.0	$2.8	**$ 28.3**

Anticipated

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	10 Year Total
					Committed Capital Spend						
Halifax	$ 7.0	$ 7.0	$ 7.0	$ 7.0	$ 7.0	$ 6.0	$ 6.0	$ 6.0	$ 6.0	$ 6.0	**$ 65.0**
HMA	$ 3.0	$ 3.0	$ 3.0	$ 3.0	$ 3.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0	$ 5.0	**$ 40.0**
					Present Value of Future Capital Spend						
Halifax	$6.6	$6.2	$5.9	$5.5	$5.2	$4.2	$4.0	$3.8	$3.6	$3.4	**$ 48.4**
HMA	$2.8	$2.7	$2.5	$2.4	$2.2	$3.5	$3.3	$3.1	$3.0	$2.8	**$ 28.3**

Note: Assumed discount rate of 6.0 percent

4. Summary of Key Points: Assumed Ad Valorem Tax revenue, present valued at 6.0 percent.

Summary of the Review of the Ad Valorem Tax Revenue (in Millions)

	Halifax Proposal				HMA Proposal			
Years	Ad Valorem Tax Rev.	Halifax Assumption	Difference	Present Value @ 6%	Ad Valorem Tax Rev.	HMA Assumption	Difference	Present Value @ 6%
1-7	$105.7	$60.2	$45.5	$34.8	$105.7	$105.7	$0.0	$0.0
8-10	45.3	19.4	25.9	15.3	45.3	-	45.3	26.8
11-15	75.5	35.7	39.8	18.8	75.5	-	75.5	35.6
16-20	75.5	40.5	35.0	12.4	75.5	-	75.5	26.5
21-25	75.5	45.7	29.8	7.9	75.5	-	75.5	19.8
Total	**$377.5**	**$201.5**	**$176.0**	**$89.2**	**$377.5**	**$105.7**	**$271.8**	**$108.7**

Years 1-7 ($34.8)

Years 1-25 $19.5

Notes:

- HCF assumed 2012 Ad Valorem Tax revenue for all years of the projection at $15.1M. Please note this analysis assumes no Ad Valorem Tax revenue after seven years for the HMA proposal. As has been noted, this commitment to never seek these Ad Valorem tax revenues after seven years was not found in the HMA Proposal nor written responses. However we understand, HMA has made verbal commitment to not seek Ad Valorem Tax after no more than seven years.
- We understand BFMC has adopted new charity care guidelines that may reduce taxes required. However, for this analysis HCF has assumed for comparison purposes that Ad Valorem taxes would remain unchanged in each of the projected years.

5. Conclusions

- **Summary.** The two Proposals from Halifax and HMA differ materially in terms of the type of remuneration for BFMC and SEVHD. It can be difficult to accurately assess the potential economic implications of each Proposal given the nature of each Proposal. Timing also impacts the analyses. For example, our review of the two Proposals indicates that for the first seven years after closing, the taxpayers would see reduced taxes with the Halifax Proposal as compared to the HMA Proposal. During this initial seven years HMA suggests it would seek funding at historical millage rates while Halifax suggests materially lower millage rates during this time period and after the first seven years. However, after that seven year time period, the HMA Proposal suggests an elimination of the taxpayer support for indigent care and bad debt at BFMC. As we have noted, HMA has not guaranteed that it would not seek continued taxpayer support after this initial seven year time period. However, we understand that HMA has made this commitment verbally. We strongly suggest if HMA is selected that SEVHD include this guarantee for this transaction and that this guarantee not negatively impact the upfront $50.0M payment by HMA.
  - Given the data provided and our review of the Proposals and the written responses provided to HCF, we believe the HMA proposal offers a more financially advantageous relationship for BFMC and for SEVHD.
- **BFMC.** Based on the information provided to HCF, and comparing the two proposals, HMA's Proposal is financially advantageous for BFMC as compared to the Halifax Proposal primarily due to the upfront cash commitment assumed in the HMA Proposal. However the following items should be considered as the amount retained SEVHD could decrease post due diligence.
  - **Pension liability.** SEVHD will be responsible for the defined benefit pension liability. SEVHD would be responsible for liabilities that could be materially higher than stated in the 2012 Audit Financial Statements.
  - **Unknown liabilities.**

5. Conclusions (Continued)

- **SEVHD.** Based on the assumption that under the HMA Proposal the Ad Valorem tax ceases after the seven year period, the HMA Proposal assumes lower taxes for SEVHD and the tax payers of the SEVHD. If the maximum payment does not cease after the seven year period the differences for the tax payers will depend on the level of taxes collected. In the first seven years of the relationship the Halifax Proposal offers a more financially advantageous deal for the tax payers, but this is quickly offset after seven years, assuming HMA does not seek tax payer funding after the seven years.
- **Other.** We noted previously, in our view selecting the organization to operate BFMC should not be driven exclusively by the financial impact. Other items that should be considered as noted previously include the following.
  - Cultural fit.
  - Ease of transition.
  - Form of structure.
  - Governance and role of remaining organizations such as SEVHD.
  - Mission.
  - Strategic alignment.
  - Sunshine Law.
  - Quality of care provided.
  - Historical relationships.
  - Medical Staff relationships/comfort with new “Parent”.